

A Leader in Accounting Education

Accountancy@UJ



ADVANCED INTERNAL AUDITING – 2014

REPLACEMENT FINAL ASSESSMENT OPPORTUNITY

NOVEMBER 2014

FIRST EXAMINERS: MR W MALHERBE
SECOND EXAMINER: PROF B MARX


TIME: 120 MINUTES
MARKS: 100 MARKS

INSTRUCTIONS:

1. This paper consists of **nineteen** pages. If your paper does not contain all the pages, please put up your hand so that a replacement paper can be handed to you.
2. Answer all the questions.
3. Answer each question on a **separate folio**.
4. Calculate the time that you should spend on each question by multiplying the number of marks for each question by 1,2 to determine the time, in minutes, available for each question. Adhere to these time constraints in order to finish the paper in the given time.
5. Delete **all** (even single open lines) open spaces on your answer sheets with pen. Pages on your answer sheets that contain open spaces will be marked as such and those pages will not be eligible for a remark.
6. No tippex or pencil may be used on your answer sheets. Pages on your answer sheets that contain pencil or tippex will be marked as such and will not be eligible for a remark.
7. All the examination regulations of the UJ and the policy document for students of the Department of Accountancy will apply during this assessment.
8. Hand this paper in, as it will be distributed with your marked answer sheet.
9. The neatness, disclosure and presentation of your answers will be taken into account when marking your paper.
10. Read questions carefully, if you need to provide explanations you should always use full sentences, refrain from simply naming facts.

QUESTION 1**50 MARKS**

Please indicate the correct answer with an X on the “multiple choice” answer sheet provided. For example:

101		B	C	D
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1. In which of the following situations would an auditor potentially lack objectivity?
 - a. An auditor reviews the procedures for a new electronic data interchange connection to a major customer before it is implemented.
 - b. A former purchasing assistant performs a review of internal controls over purchasing four months after being transferred to the internal audit activity.
 - c. An auditor recommends standards of control and performance measures for a contract with a service organization for the processing of payroll and employee benefits.
 - d. A payroll accounting employee assists an auditor in verifying the physical inventory of small motors.

2. A chief audit executive (CAE) has been requested by the audit committee to conduct an engagement at a chemical factory as soon as possible. The engagement will include reviews of health, safety, and environmental (HSE) management and processes. The CAE knows that the internal audit activity does not possess the HSE knowledge necessary to conduct such an engagement. The CAE should:
 - a. Begin the engagement and incorporate HSE training into next year's planning to prepare for a follow-up engagement.
 - b. Suggest to the audit committee that the factory's own HSE staff conduct the engagement.
 - c. Seek permission from the audit committee to obtain appropriate support from an HSE professional.
 - d. Defer the engagement and tell the audit committee that it will take several months to train internal audit staff for such an engagement.

3. A chief audit executive (CAE) for a very small internal audit department has just received a request from management to perform an audit of an extremely complex area in which the CAE and the department have no expertise. The nature of the audit engagement is within the scope of internal audit activities. Management has expressed a desire to have the engagement conducted in the very near future because of the high level of risk involved. Which of the following responses by the CAE would be in violation of the *Standards*?
- a. Discuss with management the possibility of outsourcing the audit of this complex area.
 - b. Add an outside consultant to the audit staff to assist in the performance of the audit engagement.
 - c. Accept the audit engagement and begin immediately, since it is a high-risk area.
 - d. Discuss the timeline of the audit engagement with management to determine if sufficient time exists in which to develop appropriate expertise.
4. Who has primary responsibility for providing information to the audit committee on the professional and organizational benefits of coordinating internal audit assurance and consulting activities with other assurance and consulting activities?
- a. The external auditor.
 - b. The chief audit executive.
 - c. The chief executive officer.
 - d. Each assurance and consulting function.
5. The internal audit activity of a large corporation has established its operating plan and budget for the coming year. The operating plan is restricted to the following categories: a prioritized listing of all engagements, staffing, a detailed expense budget, and the commencement date of each engagement. Which of the following best describes the major deficiency of this operating plan?
- a. Requests by management for special projects are not considered.
 - b. Opportunities to achieve operating benefits are ignored.
 - c. Measurability criteria and targeted dates of completion are not provided.
 - d. Knowledge, skills and disciplines required to perform work are ignored.

6. Which of the following comments is correct regarding the assessment of risk associated with two projects that are competing for limited audit resources?
- I. Activities that are requested by the audit committee should always be considered higher risk than those requested by management.
 - II. Activities with higher dollar budgets should always be considered higher risk than those with lower dollar budgets.
 - III. Risk should always be measured by the potential dollar or adverse exposure to the organization.
- a. I only.
 - b. II only.
 - c. III only.
 - d. I and III only.
7. Which of the following represents the best governance structure?

	Operating Management	Executive Management	Internal Auditing
a.	Responsibility for risk	Oversight role	Advisory role
b.	Oversight role	Responsibility for risk	Advisory role
c.	Responsibility for risk	Advisory role	Oversight role
d.	Oversight role	Advisory role	Responsibility for risk

8. Assessments of the independence of an organization's external auditors should:
- a. Be carried out only when the external auditor is appointed.
 - b. Not include any participation by the internal audit activity.
 - c. Include the internal audit activity only when the external auditor is appointed.
 - d. Include the internal audit activity at the time of appointment and regularly thereafter.
9. The primary reason that a bank would maintain a separate compliance function is to:
- a. Better manage perceived high risks.
 - b. Strengthen controls over the bank's investments.
 - c. Ensure the independence of line and senior management.
 - d. Better respond to shareholder expectations.

10. Which of the following statements regarding corporate governance is **not** correct?
- a. Corporate control mechanism include internal and external mechanisms.
 - b. The compensation scheme for management is part of the corporate control mechanisms.
 - c. The dilution of shareholders' wealth resulting from employee stock options or employee stock bonuses is an accounting issue rather than a corporate governance issue.
 - d. The internal auditor of a company has more responsibility than the board for the company's corporate governance.
11. What is residual risk?
- a. Impact of risk.
 - b. Risk that is under control.
 - c. Risk that is not managed.
 - d. Underlying risk in the environment.
12. During a meeting of an internal audit project team, two members of the team disagree, and one accuses the other of trying to advance personal interests over the interests of the audit. The audit manager should:
- a. Discipline both auditors after the meeting for their lack of professional conduct.
 - b. Continue the meeting but speak to the accusing auditor later regarding the inappropriate conduct.
 - c. Meet with both auditors after the meeting to resolve the conflict and the inappropriate behavior.
 - d. Stop the meeting and refer the matter to the entire team for discussion.
13. A control likely to prevent purchasing agents from favoring specific suppliers is:
- a. Requiring management's review of a monthly report of the totals spent by each buyer.
 - b. Requiring buyers to adhere to detailed material specifications.
 - c. Rotating buyer assignments periodically.
 - d. Monitoring the number of orders placed by each buyer.

14. Which of the following describes a preliminary survey?
- a. A standardized questionnaire used to obtain an understanding of management objectives.
 - b. A statistical sample to review key employee attitudes, skills and knowledge.
 - c. A walk-through of the financial control system to identify risks and the controls that can address those risks.
 - d. A process used to become familiar with activities and risks in order to identify areas for engagement emphasis.
15. An auditor, experienced in air-quality issues, discovered a significant lack of knowledge about legal requirements for controlling air emissions while interviewing the manager of the environmental, health, and safety (EHS) department. The auditor should:
- a. Alter the scope of the engagement to focus on activities associated with air emissions.
 - b. Share extensive personal knowledge with the EHS manager.
 - c. Take note of the weakness and direct additional questions to determine the potential effect of the lack of knowledge.
 - d. Report potential violations in this area to the appropriate regulatory agency.
16. An auditor has been assigned to analyze the effectiveness of a set of rehabilitation programs. The programs have been in operation for ten years and have not been evaluated. The organization providing the program data asserts that the data are incomplete. The auditor should:
- a. Perform the analysis anyway, assessing the effects of the incomplete data, but disclaim any assertion regarding data reliability.
 - b. Trace a randomly chosen set of records to source files to assess the accuracy and completeness of the data provided.
 - c. Not perform the analysis.
 - d. Postpone the analysis until data are complete.

Use the following information to answer questions 17 through to 18.

A company maintains production data on personal computers, connected by a local area network (LAN), and uses the data to generate automatic purchases via electronic data interchange. Purchases are made from authorized vendors based on production plans for the next month and on an authorized materials requirements plan (MRP) which identifies the parts needed for each unit of production.

17. The production line has experienced shutdowns because needed production parts were not on hand. Which of the following audit procedures would best identify the cause of the parts shortages?
 - a. Determine if access controls are sufficient to restrict the input of incorrect data into the production database.
 - b. Use generalized audit software to develop a complete list of the parts shortages that caused each of the production shutdowns, and analyze this data.
 - c. Select a random sample of parts on hand per the personal computer databases and compare with actual parts on hand.
 - d. Select a random sample of production information for selected days and trace input into the production database maintained on the LAN.

18. Which of the following audit procedures would be most effective in determining if purchasing requirements have been updated for changes in production techniques?
 - a. Recalculate parts needed based on current production estimates and the MRP for the revised production techniques. Compare these needs with purchase orders generated from the system for the same period.
 - b. Develop test data to input into the LAN and compare purchase orders generated from test data with purchase orders generated from production data.
 - c. Use generalized audit software to develop a report of excess inventory. Compare the inventory with current production volume.
 - d. Select a sample of production estimates and MRPs for several periods and trace them into the system to determine that input is accurate.

19. Which of the following would be **least** useful in predicting the amount of uncollectible accounts for an organization?
- a. Published economic indices indicating a general business downturn.
 - b. Dollar amounts of accounts actually written off by the organization for each of the past six months.
 - c. Total monthly sales for each of the past six months.
 - d. Written forecasts from the credit manager regarding expected future cash collections.
20. To be sufficient, audit evidence should be:
- a. Well-documented and cross-referenced in the work papers.
 - b. Based on references that are considered reliable.
 - c. Directly related to the engagement observation and include all of the elements of an engagement observation.
 - d., Convincing enough for a prudent person to reach the same conclusion as the auditor.
21. A company's accounts receivable turnover rate decreased from 7.3 to 4.3 over the last three years. What is the most likely cause for the decrease?
- a. An increase in the discount offered for early payment.
 - b. A more liberal credit policy.
 - c. A change in net payment due from 30 to 25 days.
 - d. Increased cash sales.
22. Which of the following statements are correct regarding audit engagement workpaper documentation for a fraud investigation?
- I. All incriminating evidence should be included in the workpapers.
 - II. All important testimonial evidence should be reviewed to ensure that it provides sufficient basis for the conclusion reached.
 - III. If interviews are held with a suspected perpetrator, written transcripts or statements should be included in the workpapers.
- a. I only.
 - b. II only.
 - c. II and III only.
 - d. I, II and III.

23. Which of the following most completely describes the appropriate content of engagement workpapers?
- a. Objectives, procedures and conclusions.
 - b. Purpose, criteria, techniques and conclusions.
 - c. Objectives, procedures, facts, conclusions and recommendations.
 - d. Subject, purpose, sampling information and analysis.

Use the following information to answer questions 24 through 26.

A medium-sized municipality provides 8.5 billion gallons of water per year for 31 000 customers. The water meters are replaced at least every five years to ensure accurate billing. The water department tracks unmetered water to identify water consumption that is not being billed. The department recently issued the following water activity report:

Activity	Month One	Month Two	Month Three	Actual 1st Quarter	1st Quarter Goal
Meters replaced	475	400	360	1,235	1,425
Leaks reported	100	100	85	285	
Leaks repaired	100	100	85	285	100%
Unmetered water	2%	6%	2%	4%	2%

24. Based on the activity reported for the meter replacement program, an internal auditor would conclude that:
- a. Established operating standards are understood and are being met.
 - b. Any corrective action needed has probably been taken during the quarter.
 - c. Deviations from the goal should be analyzed and corrected.
 - d. Meters should be changed every three years.
25. Based on the activity reported for leaks repaired in the first quarter, an internal auditor would conclude that:
- a. Established operating standards are understood and are being met.
 - b. Deviations from the goal should be analyzed and corrective action should be taken.
 - c. The operating standard should be changed.
 - d. The leak-repair program is overstaffed.

26. Based on the activity reported for the unmetered water, an internal audit would conclude that:
- a. Established operating standards are understood and are being met.
 - b. Further audit investigation of unmetered water is not warranted.
 - c. Deviations from the goal were probably not corrected.
 - d. The operating standard should be changed.
27. Recommendations should be included in audit reports in order to:
- a. Provide management with options for addressing audit findings.
 - b. Ensure that problems are resolved in the manner suggested by the auditor.
 - c. Minimize the amount of time required to correct audit findings.
 - d. Guarantee that audit findings are addressed, regardless of cost.
28. The primary reason for having written formal audit reports is to:
- a. Provide an opportunity for engagement client response.
 - b. Document the corrective actions required of senior management.
 - c. Provide a formal means by which the external auditor assesses potential reliance on the internal audit activity.
 - d. Record observations and recommend courses of action.
29. Which of the following is the best approach for obtaining feedback from engagement clients on the quality of internal audit work?
- a. Ask questions during the exit interviews and send copies of the documented response to the clients.
 - b. Call engagement clients after the exit interviews and send copies of the documented responses to the clients.
 - c. Distribute questionnaires to selected engagement clients shortly before preparing the internal annual activity report.
 - d. Provide questionnaires to engagement clients at the beginning of each engagement and request that the clients complete and return them after the engagements.

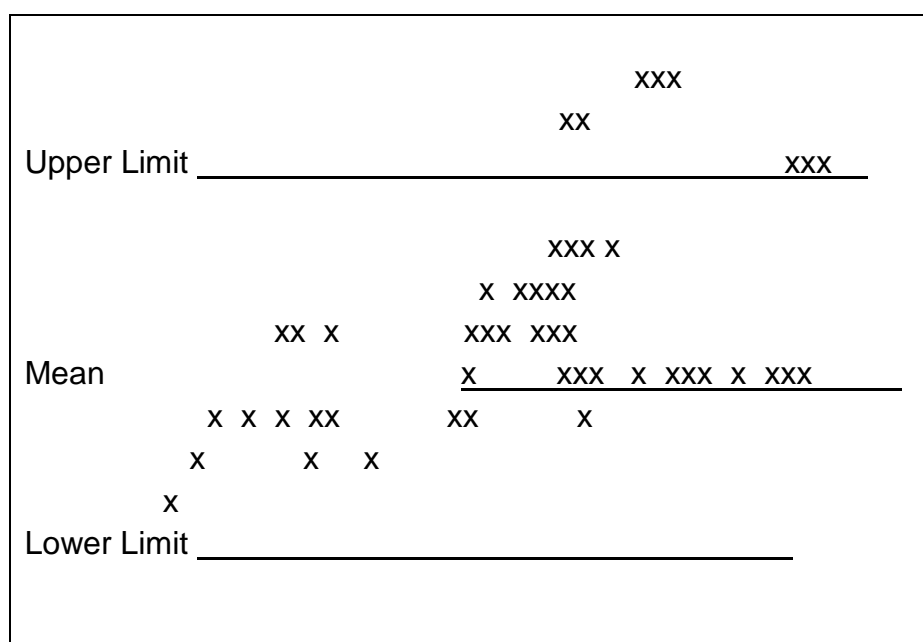
30. Which of the following control procedures would be the **least** effective in preventing frauds in which purchase orders are issued to fictitious vendors?
- a. Require that all purchases be made from an authorized vendor list maintained independently of the individual placing the purchase order.
 - b. Require that only preapproved vendors be paid for purchases, based on actual production.
 - c. Require contracts with all major vendors from whom production components are purchased.
 - d. Require that total purchases from all vendors for a month not exceed the total budgeted purchases for that month.
31. An auditor is considering developing a questionnaire to research employee attitudes toward control procedures. Which of the following represents the **least** important criteria in designing the questionnaire?
- a. Questions should be worded to ensure a valid interpretation by the respondents.
 - b. Questions should be reliably worded so that they measure what was intended to be measured.
 - c. The length of the questionnaire should be minimized in order to increase the response rate.
 - d. Questions should be worded such that a "No" answer indicates a problem.
32. Which of the following procedures would be appropriate for testing whether cost overruns on a construction project were caused by the contractor improperly accounting for costs related to contract change orders?
- I. Verify that the contractor has not charged change orders with costs that have already been billed to the original contract.
 - II. Determine if the contractor has billed for original contract work that was canceled as a result of change orders.
 - III. Verify that the change orders were properly approved by management.
- a. I only.
 - b. III only.
 - c. I and II only.
 - d. I and III only.

33. In conducting an audit of an organization's disaster recovery capability, which of the following would an auditor consider to be the most serious weakness?
- a. Tests utilize recovery scripts.
 - b. Hot-site contracts are two years old.
 - c. Backup media are stored on-site.
 - d. Only a few systems are tested annually.
34. If electronic funds transfer (EFT) is used to pay vendor invoices, which of the following computer-assisted audit procedures would an auditor use to determine if any payments were made twice?
- I. Identification of EFT transactions to the same vendor for the same dollar amount.
 - II. Extraction of EFT transactions with unauthorized vendor codes.
 - III. Testing of EFT transactions for reasonableness.
 - IV. Searching for EFT transactions with duplicate purchase order numbers.
- a. I and II only.
 - b. I and IV only.
 - c. II and III only.
 - d. III and IV only.
35. Which of the following is true of benchmarking?
- a. It is typically accomplished by comparing an organization's performance with the performance of its closest competitors.
 - b. It can be performed using either qualitative or quantitative comparisons.
 - c. It is normally limited to manufacturing operations and production processes.
 - d. It is accomplished by comparing an organization's performance to that of the best-performing organizations.
36. A consulting activity appropriately performed by the internal audit activity is:
- a. Designing systems of control.
 - b. Drafting procedures for systems of control.
 - c. Reviewing systems of control before implementation.
 - d. Installing systems of control.

37. Sales representatives for a manufacturing company are reimbursed for 100 percent of their cellular telephone bills. Cellular telephone costs vary significantly from representative to representative and from month to month, complicating the budgeting and forecasting processes. Management has requested that the internal auditors develop a method for controlling these costs. Which of the following would most appropriately be included in the scope of the consulting project?
- a. Control self-assessment involving sales representatives.
 - b. Benchmarking with other cellular telephone users.
 - c. Business process review of procurement and payables routines.
 - d. Performance measurement and design of the budgeting and forecasting processes.
38. An audit of accounts payable found that the individuals responsible for maintaining the vendor master file could also enter vendor invoices into the accounts payable system. During the exit conference, management agreed to correct this problem. When performing a follow-up engagement of accounts payable, the auditor should expect to find that management had:
- a. Transferred the individuals who maintained the vendor master file to another department to ensure responsibilities were appropriately segregated.
 - b. Compared the vendor and employee master files to determine if any unauthorized vendors had been added to the vendor master file.
 - c. Modified the access control system to prevent employees from both entering invoices and approving payments.
 - d. Modified the accounts payable system to prevent individuals who maintained the vendor master file from entering invoices.
39. Which of the following statements best describes the internal audit activity's responsibility for follow-up activities related to a previous engagement?
- a. Internal auditors should determine if corrective action has been taken and is achieving the desired results or if management has assumed the risk of not taking the corrective action.
 - b. Internal auditors should determine if management has initiated corrective action, but they have no responsibility to determine if the action is achieving the desired results. That determination is management's responsibility.
 - c. The chief audit executive is responsible for scheduling follow-up activities only if directed to do so by senior management or the audit committee. Otherwise, follow-up is entirely discretionary.
 - d. None of the above.

40. Questions used to interrogate individuals suspected of fraud should:
- Adhere to a predetermined order.
 - Cover more than one subject or topic.
 - Move from the general to the specific.
 - Direct the individual to a desired answer.
41. An auditor for a major retail company suspects that inventory fraud is occurring at three stores that have high cost of goods sold. Which of the following audit activities would provide the most persuasive evidence that fraud is occurring?
- Use an integrated test facility (ITF) to compare individual sales transactions with test transactions submitted through the ITF. Investigate all differences.
 - Interview the three individual store managers to determine if their explanations about the observed differences are the same, and then compare their explanations to that of the section manager.
 - Schedule a surprise inventory audit to include a physical inventory. Investigate areas of inventory shrinkage.
 - Select a sample of individual store prices and compare them with the sales entered on the cash register for the same items.
42. What computer-assisted audit technique would an auditor use to identify a fictitious or terminated employee?
- Parallel simulation of payroll calculations.
 - Exception testing for payroll deductions.
 - Recalculation of net pay.
 - Tagging and tracing of payroll tax-rate changes.
43. Which sampling plan requires no additional sampling once the first error is found?
- Stratified sampling.
 - Attributes sampling.
 - Stop-or-go sampling.
 - Discovery sampling.

44. The following I-bar chart is an example of the output from a computer application used by a health insurance company to monitor physician bill amounts for various surgical procedures:



The data plotted on the chart represents:

- Random variation.
 - Abnormal variation.
 - Normal variation.
 - Cyclic variation.
45. Which of the following is **not** an advantage of sending an internal control questionnaire prior to an audit engagement?
- The engagement client can use the questionnaire for self-evaluation prior to the auditor's visit.
 - The questionnaire will help the engagement client understand the scope of the engagement.
 - Preparing the questionnaire will help the auditor plan the scope of the engagement and organize the information to be gathered.
 - The engagement client will respond to the questions asked, without volunteering additional information.

46. As used in the verification of an accounts payable schedule, which of the following is best described as an analytical test?
- a. Comparing the items on the schedule with the accounts payable ledger or unpaid voucher file.
 - b. Comparing the balance on the schedule with the balances of prior years.
 - c. Comparing confirmations received from selected creditors with the accounts payable ledger.
 - d. Examining vendor's invoices in support of selected items on the schedule.
47. Which of the following analytical review procedures should an auditor use to determine if a change in investment income during the current year was due to changes in investment strategy, changes in portfolio mix, or other factors?
- a. Simple linear regression of investment income changes over the past five years to determine the nature of the changes.
 - b. Ratio analysis of changes in the investment portfolio on a monthly basis.
 - c. Trend analysis of changes in investment income as a percentage of total assets and of investment assets over the past five years.
 - d. Multiple regression analysis using independent variables related to the nature of the investment portfolio and market conditions.
48. A production manager ordered excessive raw materials for delivery to a separate company owned by the manager. The manager falsified receiving documents and approved the invoices for payment. Which of the following audit procedures would most likely detect this fraud?
- a. Select a sample of cash disbursements and compare purchase orders, receiving reports, invoices, and check copies.
 - b. Select a sample of cash disbursements and confirm the amount purchased, purchase price, and date of shipment with the vendors.
 - c. Observe the receiving dock and count materials received; compare the counts to receiving reports completed by receiving personnel.
 - d. Perform analytical tests, comparing production, materials purchased, and raw materials inventory levels; investigate differences.
49. When using a rational decision-making process, the next step after definition of the problem is:
- a. Developing alternative solutions.
 - b. Identifying acceptable levels of risk.
 - c. Recognizing the gap between reality and expectations.
 - d. Confirming hypotheses.

50. An organization provides credit cards to selected employees for business use. The credit card company provides a computer file of all transactions by employees of the organization. An auditor plans to use generalized audit software to select relevant transactions for testing. Which of the following would **not** be readily identified using generalized audit software?
- a. High-dollar transactions.
 - b. Fraudulent transactions.
 - c. Transaction for specific cardholders.
 - d. Suppliers used by each cardholder.

QUESTION 2**50 MARKS****PART A****25 MARKS**

CandyMan (Pty) Ltd (Hereafter CML) is a large manufacturer and wholesaler of a wide range of sweets e.g. chocolate, toffee, sour sweet etc. Controls are sound and include an internal audit department which is staffed by competent internal auditors. Internal audit activities are scheduled at the start of each financial year, but during the year, numerous requests are received from within the company for “internal audit” to carry out various assignments.

The following requests have been received by Ben Wessels, who is the chief audit executive of CML:

1. The financial director has asked the internal audit department to design and implement a costing system for a new type of product which is to be manufactured.
2. The warehouse manager has requested internal audit to perform an audit to determine whether the company is complying with all necessary safety regulations e.g. fire protection, ventilation etc.
3. The production director has requested internal audit to conduct an inventory cycle counts in the finished goods warehouse on an ongoing basis.
4. The board of directors has requested internal audit to assist in identifying, evaluating and assessing significant organisational risks.
5. The sales director has requested internal audit to evaluate the operational efficiency of the company's procedures for placing tenders for the supply of the company's products to government departments (who has very strict policies and requirements in awarding a tender).

YOU ARE REQUIRED TO:		MARKS								
a)	<p>Indicate whether the CAE should accept or reject each of the above requests. Your answer should be supported by a discussion of the factors he should consider, based on the definition of internal auditing only.</p> <p>Your answer should be in the following format:</p> <table><tr><th>Accept / Reject Engagement</th><th>Considerations</th></tr><tr><td>1.</td><td></td></tr><tr><td>2.</td><td></td></tr><tr><td>Etc.</td><td></td></tr></table>	Accept / Reject Engagement	Considerations	1.		2.		Etc.		(25)
Accept / Reject Engagement	Considerations									
1.										
2.										
Etc.										
b)	Discuss the detailed responsibilities of internal audit to manage fraud in an organisation as set by the International Standards for the Professional Practice of Internal Auditing.	(8)								
c)	Discuss whether an employee's act of stealing money from a cash register, can be regarded as fraud according to the International Standards for the Professional Practice of Internal Auditing.	(2)								
d)	Discuss the internal auditor's considerations and response when a deviation is found in a sample, while testing the effectiveness of an internal control.	(15)								
	Total Marks:	(50)								